State of California
Department of Insurance
45 Fremont Street, 21st Floor
San Francisco, California 94105

EMERGENCY RE-ADOPTION OF REGULATION PURSUANT TOCALIFORNIA GOVERNMENT CODE SECTION 11346.1(h)

Section 2361. CONSIDERATION OF LOSSES AND LOSS EXPOSURE IN RESIDENTIAL PROPERTY INSURANCE RATING AND UNDERWRITING

File No. ER03030135 **July, 1, 2004**

Re-adopt Title 10, California Code of Regulations, Chapter 5, Subchapter 3, Article 7.2, Section 2361.

California Insurance Commissioner John Garamendi ("the Commissioner") hereby re-adopts on an emergency basis a new regulation: CCR §2361of Article 7.2 of Subchapter 3 of Chapter 5 of Title 10 of the California Code of Regulations (CCR).

This Notice incorporates by reference any and all documents associated with the Office of Administrative law file numbers 03-0710-03E, 03-1110-02EE and 04-0303-01 EE.

NOTE: This document contains **<u>updated</u>** information relating to the facts upon which the Commissioner bases his finding that there exists an emergency that threatens the health, safety and welfare of the citizens of California requiring emergency regulatory action.

A. Emergency Regulations Text and STD. Form 400. (7 copies)

Seven copied of the text of the regulation is attached and STD. Form 400 signed by Deputy Commissioner and General Counsel Gary Cohen is attached.

Also attached is a true and correct copy of the Notice and the text attached to the Notice issued June 25, 2004 pursuant to California Insurance Code §12921.7, submitting for re-adoption Title 10, Chapter 5, Subchapter 3, Article 7.2, §2361 of the California Code of Regulations (Cal. Code Regs., tit. 10, §2361) to the Office of Administrative Law for approval pursuant to California Government Code §11346.1(h).

B. Agency Express Finding of Emergency.

The Commissioner finds that for the specific reasons explained below an emergency **<u>continues</u>** to exist which makes the immediate re-adoption of this regulation on an emergency basis necessary for the preservation of the public peace, health, safety and general welfare. .

C. <u>Updated</u> agency statement of specific facts showing the need for immediate action.

1. Introduction

Beginning in 2002 a convergence of forces and unforeseen circumstances came together in California to create a crisis in the residential property insurance[1] market. For the reasons explained below California **<u>continues</u>** to face a crisis related to the availability homeowners insurance. The insurance industry, consumer protection groups, the press and the general public l became aware of the situation in 2002 and 2003. The situation is now being exacerbated due to claims associated with the Southern California firestorms that occurred last fall. The current crisis is of such a scope and magnitude that the Commissioner believes immediate action is required to avert any further deterioration of the residential property insurance market and to avoid an unprecedented residential property insurance availability crisis.

Upon the initial adoption of this regulation on an emergency basis in June of 2003, various insurance industry trade groups filed suit against the Commissioner in Sacramento Superior Court in an attempt to have the Commissioner enjoined from enforcing this emergency regulation. **This matter is currently on appeal to the Court of Appeal of the State of California in and for the Third Appellate District (Court of Appeal Number C045000). In order to keep this litigation viable this regulation must be re-adopted on an emergency basis. If the regulation is allowed to lapse the case will be mooted.**

While there are laws specific to insurance rating and underwriting that address cancellation, nonrenewal and eligibility for homeowners insurance, both the insurance industry and the insurance consuming public are unclear as to the exact application of these laws. This regulation is specifically **<u>designed to define, clarify and make specific the application of these laws in California.</u>**

2. Cancellation, Nonrenewal, Eligibility and Surcharges

The **continuing** crisis in the residential property insurance market centers around the cancellation and nonrenewal of existing homeowners coverage and a general lack of availability due to underwriting and eligibility guidelines applied by insurers that appear in many cases to be in noncompliance with the current insurance laws. The situation has been referred to in the press, and by the Commissioner, as “use it and lose it.”

Under the “use it and lose it” scenario, when policyholders make a claim against their insurance policy that policy is non-renewed based on the fact that the policyholder made a claim. The insurance industry has taken the position that a person who makes a claim is more apt to make another claim and therefore represents a greater risk. For this reason the insurance industry does not want to insure people who make claims. Despite numerous requests, to date the insurance industry has not furnished the Commissioner with data to support the contention that a person who makes a claim is more apt to make another claim.

Once the policyholder is put on notice of the non-renewal, the policyholder is then forced to try to procure insurance elsewhere. With so many companies refusing to write insurance for any person who has made a claim, procuring residential property coverage has become extremely difficult for many Californians. It should be noted that even simple coverage inquiries have been

[1] Residential property insurance is more commonly known as “homeowners” insurance.

used as the basis for cancellation and nonrenewal of insurance coverage. Many of these non-renewals are based on information collected by insurance-support organizations. These “CLUE” reports have been shown to be prone to error. However, even where the data is erroneous it is still used by insurers to non-renew policies. At the present times the insurance industry has taken the position that it is not required to make any affirmative attempt to verify the accuracy of this claims-history data. This regulation is designed to make it clear to the insurance industry that they are responsible for seeing to the accuracy of all data used in underwriting policies of residential property insurance.

The Commissioner has ample evidence in the form of consumer complaints and media reports to believe that much of the data contained in these databases is imperfect and inconsistent, and reliance upon these imperfect and inconsistent databases may result in unfairly discriminatory treatment of policyholders and applicants (please see previous submissions). Even where the data in the databases is not flawed, current law in California requires that underwriting decisions not be based solely on the contents of the databases but only after further information is gathered from a source or sources other than that gathered from the insurance-support organization. These requirements are being ignored by many California insurers who cite “ambiguities” in the law as a defense. This regulation is designed to clear up any ambiguity. The regulation that is the subject of this notice is designed to make the law more clear.

Some companies, instead of non-renewing policies, have taken to surcharging the policies. Some surcharges can be me as much as 100%, making the policy unaffordable, creating further market constriction. The proposed regulation addresses these situations because an increase in premium is considered an “adverse action” within the meaning of the insurance code and this regulation.

Also, current law requires insurers to evaluate the risk of future loss in making any decision relating to eligibility for residential property insurance. The Commissioner has determined that insurance industry reliance on these databases is exacerbating the availability crisis and that many insurers are ignoring the law related to eligibility requirements. This regulation is designed to make the law clear as to eligibility, rating and **<u>underwriting</u>**.

As previously stated, by defining certain terms and providing concrete examples this regulation is intentionally and specifically designed to clear up any ambiguity in this area of the insurance laws. The Commissioner believes that it is imperative that this regulation be re-adopted. **<u>As it stands today</u>** the crisis will continue and insurers will continue to ignore and / or misinterpret the laws relating to underwriting and rating evaluations currently should this regulation be allowed to lapse.

The Commissioner has determined that these practices are not based on sound reasoning, are unfair and have created an insurance availability crisis in California that continues to this day and could, as is explained below in great detail, due to claims made relating to the Southern California Wildfires, grow to even more dangerous proportions.

3. Consumer Complaints in 2004

In 2002 and 2003 CDI experienced an unprecedented increase in complaints from consumers regarding residential property insurance cancellation, nonrenewal and eligibility.

In 2004 CDI continues to receive voluminous complaints from policyholders who have been denied coverage or had coverage terminated due to making claims or due to insurance companies relying solely on insurance-support organization databases that have been shown to, in many cases, contain incomplete or erroneous loss history data.

Throughout 2001, CDI received only 318 formal complaints regarding homeowners insurance. In contrast, by the third quarter of 2002, CDI had received 1,200 written complaints from consumers, making the subject of homeowners insurance the number one consumer complaint issue in Property and Casualty lines at the Department of Insurance. **In 2004** the number of complaints received from January, 2004, through June 16, 2004, would indicate at least a 100% increase in complaints as compared to 2001. This is an inordinate and unusually high number of complaints. Clearly, **the crisis in homeowners insurance availability continues** in California impacting the health, safety and welfare of all Californians.

The fact that complaints continue apace proves that there a **continuing emergency** in the homeowners insurance market in California. Clearly, using consumer complaints as a gauge, the crisis in homeowners insurance availability continues in California impacting the health, safety and welfare of all Californians.

Below is a thumbnail schedule of complaints received by CDI relating to the issues addressed by this regulation, through June 30, 2003.

	7/1/01 - 6/30/02	7/1/02 - 6/30/03	% Increase
Refusal to Insure	311	578	85%
Cancellation	573	939	64%
Nonrenewal	1007	1713	70%
Totals	1891	3230	71%

Below is an **updated** schedule of complaints received by CDI relating to the issues addressed by this regulation, through **June 30, 2004**.

Updated Homeowners Insurance Consumer Complaints
Relating to Rating and Underwriting Practices

Based upon consumer complaints received by the CDI, the major issues facing the residential insurance market are non-renewals, cancellations, refusal to insure, premium rating/misquotes, credit report and credit score use and the improper use of CLUE. Written complaints have increased threefold over the 2001 and 2002 calendar years.

Reason Code	Code #	2001	2002	2003	1/1/04 – 6/16/04
Refusal to Insure	0810	22	105	121	24
Cancellation	0815	150	373	352	129
Nonrenewal	0816	202	543	619	179
Premium Rating/Misquotes	0805	89	359	300	131
Surcharge	0829	1	60	92	4
Credit Report	0818	4	34	23	0
		468	1,474	1,507	467

The Commissioner believes these numbers evidence a significant and severe trend. While it might be argued that the 2004 numbers are not as severe as the 2002 and 2003 numbers, in actuality the number of complaints on a pace that will result in a 100% increase as compared to 2001.

We would note that complaint trends associated with the Southern California wildfires which occurred in October of 2003, (a subject which is discussed in detail below) will not begin to emerge until homes are rebuilt and insurance is needed. While "use it and lose it" complaints from the fire survivors have started to come into CDI, because a significant number of homes have not been rebuilt, no insurance need be procured. Because so many homes are destroyed in a disaster like the wildfires, there are not enough contractors to re-build all the homes at once. CDI would not expect wildfire related complaints to dramatically increase until more homes are actually rebuilt. Using history as a guide, the complaint "lag-time" as it would relate to people unable to obtain coverage is 10 to 12 months after the disaster.

4. Continued Availability Crisis

The Commissioner believes that the continued, unprecedented number of complaints relating to cancellation, nonrenewal, and unavailability of homeowners insurance is evidence that **<u>there continues to be a homeowners insurance availability crisis in California</u>.** The crisis continues to threaten immediate harm to California real estate and financial markets which could have a direct impact on California's already sluggish economic recovery. This continuing crisis has an immediate and profound effect on the consumers of this state who, due to an inability to secure coverage, may be unable to either purchase or sell a home or who upon cancellation may be involuntary transferred into the costly residual or forced-place insurance markets. The Commissioner believes this problem will be extremely acute in the areas hit by last fall's wildfires.

The Commissioner has determined that a significant number of Californians continue to find it impossible to purchase insurance or had their insurance cancelled or not renewed. Further, the

Commissioner believes that many insurers may have cancelled or non-renewed coverage in noncompliance with the California Insurance Code and California Code of Regulations. Many insurers in applying cancellation, nonrenewal and underwriting rules that are not clearly defined, or that rely solely on imperfect and inconsistent databases alone, have aggravated the insurance availability crisis in California.

This crisis is evidenced in the startling increase in the number of consumer complaints received by CDI and by scores of media reports on the lack of availability of homeowners policies (please see previous submissions.) Indeed, in Sacramento in both 2003 and 2004 the homeowner's availability crisis was at the top of the legislative agenda all year. The Commissioner continues to communicate with the real estate and financial industries and with various constituents who are being impacted by this crisis.

5. The Continuing Legal Challenge

The Commissioner recognizes the growing problem of homeowner insurance availability and continues to work hard to find solutions. He has attempted to resolve the situation by working with individual insurers on a one on one basis. He has attempted to communicate his concerns to the industry as a whole. Not only has there been little discernable improvement in the situation but these efforts have been met with a lawsuit filed by various insurance industry trade groups challenging the Commissioner's authority to enforce the insurance laws and promulgate this regulation. (American Insurance Association; Association of California Insurance Companies; Personal Insurance Federation of California v. John Garamendi, Superior Court of the State of California, County of Sacramento, Case No. 03CS00839.)

During the course of the hearing challenging the Commissioner's authority to enforce the insurance laws, specifically related to the "Advisory Notice" issued by the Commissioner, which took place on June 12, 2003, counsel for the insurance industry stated that an emergency exists in the California homeowners insurance market due to inherent ambiguity in the law. The judge, Superior Court Judge Raymond M. Cadei, agreed with counsel for the industry that an emergency exists in the California homeowners insurance market due to inherent ambiguity in the law. The Commissioner understood the judges ruling from the bench to mean the Commissioner was required to adhere to the APA process in issuing the "Advisory Notice." In keeping with the court's instruction the Commissioner promulgated this regulation.

This regulation is designed to make clear and precise the application of the law in California, applying the formal rulemaking procedure as CDI was instructed by the court to do and is specifically designed to clear up any and all ambiguity as to the application of the insurance laws in this area.

Much has happened since June 2003. What follows is a timeline of the **<u>continuing litigation</u>**.

On June 3, 2003, a lawsuit was filed challenging the Commissioner's authority to enforce the insurance laws. (American Insurance Association; Association of California Insurance Companies; Personal Insurance Federation of California v. John Garamendi, Superior Court of the State of California, County of Sacramento, Case No. 03CS00839.) The following is an update of the ongoing litigation.

On June 12, 2003, during the course of the hearing challenging the Commissioner's authority to enforce the insurance laws, counsel for the insurance industry stated that an emergency existed in the California homeowners insurance market due to inherent ambiguity in the law.

On June 13, 2003, an order granting the alternative writ/order to show cause and temporary stay and injunction was entered. The judge, Superior Court Judge Raymond M. Cadei, agreed with counsel for the industry that an emergency exists in the California homeowners insurance market due to inherent ambiguity in the law.

On July 9, 2003, the Department filed emergency regulations to clarify the ambiguity in California Law. The emergency regulation was designed to make clear and precise the application of the law in California, applying the formal rulemaking procedure as CDI was instructed by the court to do and was specifically designed to clear up any and all ambiguity as to the application of the insurance laws in this area.

On July 22, 2003 various trade associations of insurance companies filed an *ex parte* application for an alternative writ of mandate / order to show cause and temporary stay order and/or injunction seeking to obtain an order directing the Insurance Commissioner to cease and desist from enforcing the new emergency regulation, Title 10, section 2361 of the California Code of Regulations, and staying enforcement of the regulation.

Regular rulemaking was initiated on July 22, 2003 with the filing of RH03031129, OAL File Number Z-03-0722-18. The permanent rulemaking is still pending.

On August 6, 2003 the court issued an Order on Petitioners' *Ex Parte* Application for Alternative Writ of Mandate / Order to Show Cause heard on July 23, 2003. The order directed the Commissioner to cease and desist from enforcing the emergency regulation. The court also issued the Alternative Writ of Mandate as requested by Petitioners that directed the Commissioner to cease and desist from enforcing the emergency regulation.

Also on August 6, 2003 Insurance Commissioner Garamendi filed a Demurrer to the Amended Petition for Peremptory Writ of Mandate on the ground that Petitioners failed to allege facts sufficient to support a cause of action.

On August 8, 2003 the court issued a tentative ruling in favor of Petitioners that granted the Writ of Mandate on the ground that respondent Garamendi exceeded his authority in promulgating the regulation.

On August 22, 2003 the matter was argued and submitted.

On August 25, 2003 the court issued a ruling in favor of Petitioners, granting the Writ of Mandate on the ground that respondent Garamendi exceeded his authority in promulgating the regulation.

On September 12, 2003 that parties were unable to agree as to the form of the Order. Respondent Insurance Commissioner Garamendi filed an Objection to the Peremptory Writ of Mandate and Judgment relating to the form of the Writ and Judgment.

Also on September 12 2003 the Petitioners filed their proposed Order and Judgment. This order was the same proposed Order and Judgment to which Respondent Insurance Commissioner Garamendi objected.

On September 14, 2003 Petitioners filed an *Ex Parte* Application relating to the form of the Order and Judgment. Oral argument was set for September 15, 2003.

On September 15, 2003 Respondents filed a response to Petitioners' *Ex Parte* Motion regarding the Form of the Order which was filed on September 14, 2003.

On September 15, 2003 the Parties stipulated to the form of the Order and Judgment.

On September 16, 2003 Respondent Insurance Commissioner Garamendi filed a Notice of Appeal. The Notice of Appeal put the parties and all interested persons on notice that the Commissioner intended to appeal the decision of the trial court to the Court of Appeal.

On November 17, 2003 Petitioners filed a Notice of Motion and Motion Pursuant to Code of Civil Procedure pursuant Section 1110b. That motion challenged the automatic stay of the judgment below upon appeal pursuant to Code of Civil Procedure section 916.

On December 2, 2003 Respondent Insurance Commissioner filed a Memorandum of Points and Authorities in Opposition to Petitioners Motion.

On December 5, 2003 Petitioner filed a Reply in Support of its Motion Pursuant to Code of Civil Procedure Section 1110b. (Challenging Code of Civil Procedure section 916.)

On December 12, 2003 oral argument took place in Sacramento Superior Court Dept. No. 25

On December 16 2003 judgment was issued pursuant to Code of Civil Procedure 1110b in favor of Respondent Insurance Commissioner. The Court held that the judgment below was stayed pending the appeal per Code of Civil Procedure 916.

On January 20, 2003 the Department filed its opening brief.

On February 19, 2003 Respondents filed their brief.

On or around April 26, 2004 California Supreme Court decided *State Farm Mutual Automobile Insurance Company et al. v. Garamendi* (April 26, 2004, S102251) ___Cal.4th___ [04 C.D.O.S. 3571] (hereafter "*State Farm*"). The advent of this decision sparked another round of briefing as the case was germane and relevant to the questions relating to the Commissioner's authority to promulgate the regulation that is the subject of this notice.

The *State Farm* case serves as a timely reminder of the voters' intent in adopting Proposition 103. The California Supreme Court, in the *State Farm* case, unanimously affirmed two bedrock principles that are relevant to the case presently before this Court of Appeal: The Commissioner's broad authority to promulgate regulations under the mandate of Proposition 103; and the long held rule that statutes should never be interpreted so as to render statutory language a nullity.

As was stated in Appellant's Reply Brief, the case at issue here turns on two key questions: Whether Proposition 103 provides authority for the Commissioner to issue the regulations in question; and whether the Insurance Information Privacy Protection Act should be interpreted in a way that renders the act a nullity. As is discussed herein, in *State Farm*, the Supreme Court has answered these questions, unequivocally.

As to the first question, the California Supreme Court held the Commissioner has broad authority to issue regulations other than those that apply strictly to rates and rating. The Court held that the Commissioner has broad authority to issue regulations addressing issues of fairness and availability in the insurance market. As to the second question, the Supreme Court reiterated the long standing rule that statutes are not to be construed so as to render the statutory language a nullity.

The Commissioner's opponents contend that the Commissioner's authority under Proposition 103 extends only to the regulation of rates. The Commissioner believes that the Commissioner's regulatory authority under Proposition 103 is very broad and certainly extends to the regulation of underwriting. In *State Farm*, the Supreme Court was unequivocal in making it clear that the Commissioner's position is correct. In arriving at its conclusions the Court relied on the same line of cases, interpreting the same statutes, as were relied on by the Commissioner in support of his position that he has the authority to promulgate the regulation that is the subject of this notice.

In the *State Farm* case, State Farm argued, as Respondents do here, that the Commissioner exceeded his statutory authority in the promulgation of a regulation. In affirming the decision of the Court of Appeal that the regulation was valid, the Supreme Court stated, "Article 10 is not only about rates and rate regulation; it also concerns other factors that may impermissibly affect the availability of insurance." (*State Farm*, *supra*, 04 C.D.O.S. at page 3574.) This is precisely the position taken by the Commissioner in his briefs in this case.

The Supreme Court also clearly stated that the Commissioner's authority under Proposition 103 "is not limited in scope to rate regulation. It also addresses the underlying factors that may impermissibly affect rates charged by insurers and lead to insurance that is unfair, unavailable, and unaffordable." (Our emphasis) (*State Farm*, *supra*, 04 C.D.O.S. at page 3574.) As it was briefed, where "underlying factors" such as underwriting rules have both a direct and indirect impact on rates, the Commissioner's authority to regulate those factors is clear. Similarly, where "underlying factors" such as underwriting rules result in unfair treatment of consumers, adversely impact the availability of insurance and/or result in rates which are unfair or unaffordable, the Commissioner's authority to regulate those factors is clear.

Given the holding and discussion in *State Farm*, any contention that Commissioner's authority under Proposition 103 is strictly confined to "rates and rate regulation" should be rejected.

The *State Farm* case also reminds us that, when construing statutes enacted through the initiative process, "a court must look first to the words themselves, giving to the language its usual, ordinary import and according significance, if possible, to every word, phrase and sentence…" (*State Farm*, *supra*, 04 C.D.O.S. at page 3574.) Additionally, statutes must be read "with reference to the entire scheme of law of which it is part so that the whole may be harmonized and retain effectiveness." (*Ibid*.)

The insurance industry's interpretation of Insurance Code section 791 *et seq.*, otherwise known as the Insurance Information and Privacy Protection Act, renders the act a nullity. As stated succinctly and clearly by the Court in *State Farm*, "An interpretation that renders statutory language a nullity is obviously to be avoided." (*State Farm*, *supra*, 04 C.D.O.S. at page 3574.) Respondents assert that once a claim is made, any and all "personal information," as defined in the IIPPA, becomes "privileged information" as defined in the IIPPA. The impact of this interpretation is to nullify the almost all the protections afforded by the IIPPA. Specifically, sections 791.02, 791.04, 791.06, 791.07, 791.09, 791.12 791.13, in whole or in part, are nullified. Indeed, Respondents' interpretation nullifies such a great deal of the statutory language in the IIPPA that the act itself is reduced to a nullity.

The *State Farm* case is relevant and important here because it reaffirms the law interpreting Proposition 103 in a way that furthers the purposes of the initiative and allows the Commissioner to fulfill his duty to enforce the law as it was written and enacted according to the wishes of the voters of California.

Supplemental briefing resulting from the advent of the *State Farm* case was concluded on June 28, 2004. The parties are currently waiting for the court to schedule oral argument. CDI attorneys are confident that the date will be set very soon.

Given the legal history of this case, if the Commissioner is to perform his statutory obligation to enforce the insurance laws of this state and protect the interests of consumers and the insurance industry alike, he has no other avenue to pursue than promulgation of these regulations on an emergency basis as he has been enjoined from enforcing the law as interpreted in the "Advisory Notice" that was found to be an underground regulation.

Given the availability crisis as described above, and given the Insurance Commissioner's current inability to apply the laws without legal challenge, there exists good reason for the recognition of an emergency.

An untold number of work hours have been put toward the litigation of this case. If this regulation is not re-adopted all the work and all the rate payers' dollars spent in litigating this case will be reduced to waste. As litigation in this matter is still pending, the emergency regulations should be extended for an additional 120 days. It is imperative that if the matter is favorably resolved, that the Department be able to enforce immediately the emergency regulations pending completion of the permanent rulemaking process.

The Commissioner understands that the better practice is for an emergency regulation to be renewed no more than one or two times before the process of noticing a hearing to have regulations approved permanently. However, the protracted litigation in this case makes that approach impracticable. Under the circumstances in this matter, as we will not know the outcome of the appeal, it would be an inordinate and unwarranted use of state time and resources to notice a hearing and to make the regulations permanent only to start the litigation process from "square one" once the permanent regulation is adopted. It goes without saying **that the insurance industry will challenge a permanent regulation on the same grounds they challenged the emergency regulation.**

Accordingly we request that the emergency regulations be readopted for an additional 120-day period. **It is the Commissioner's intention, should he prevail on the merits, to start the permanent regulation process immediately upon the order of the court.** However, it is imperative that the emergency regulation be kept in place to preserve the Commissioner's appeal. If the regulation is allowed to lapse untold numbers of hours of legal work and untold numbers of ratepayer dollars will have been spent needlessly. In these days of shrinking state budgets, resource shortages and diminishing state personnel available to work on these matters, such an outcome would be a tragedy that would not only be antithetical to the interests of justice, it would in all likelihood result in a dangerous negative impact on California citizens and the California economy.

6. Southern California Firestorms / Cancellations and Non-renewals

The Commissioner has personally visited areas in Southern California devastated by firestorms which raged through Southern California in late 2003. While, as was explained above, it is too soon to provide detailed statistical evidence for the rulemaking file, anecdotal evidence points toward several alarming trends which will act to exacerbate the insurance availability crisis in California.

A. Firestorm "Use It and Lose It"

Complete firestorm data is not yet available due to the lag-time between the disaster and the rebuilding of homes. However, in numerous town hall meetings conducted by the Commissioner in the firestorm areas, a plethora of anecdotal evidence has been gathered by CDI personnel relating to the aforementioned "use it and lose it" scenario.

Some fire victims who did not suffer total losses as a result of the firestorm have been non-renewed by their insurers and have had difficulty in procuring insurance due to their having made claims related to the firestorm. Other victims who suffered total losses who have purchased homes in areas outside of the firestorm areas, instead of rebuilding on their old lots within the firestorm areas, have experienced trouble procuring insurance coverage because they made claims related to the firestorms. Some victims who have settled their claims with insurers and have begun the rebuilding process have had difficulties finding coverage due to claims made resulting from the wildfires.

Some insurers have cancelled or non-renewed coverage where the insured suffered a total loss citing Insurance Code section 676(c). These victims have voiced concern regarding their ability to get coverage later after they rebuild. Some have been told by their agents that insurance from their former insurers will not be available. Again, due to the amount of time it takes to rebuild in cases like this CDI does not presently have data sufficient to establish a trend. However, anecdotal evidence gathered from firestorm survivors at the several town hall meetings held in the fire areas indicate that many will have trouble procuring insurance simply because they made a claim against their insurance policy. All indications point toward further constriction in the market as policy holders are locked out of the market for making claims against their insurance policies.

The emergency regulation that is the subject of this notice is designed to address these issues and to help make sure that homeowners insurance remains available in California by requiring insurers to show that underwriting rules and guidelines bear a substantial relationship to risk of loss. The Commissioner questions the fairness of refusing to write insurance for a person who has been the victim of circumstances beyond his or her control. The Commissioner does not believe firestorm victims should be locked out of the insurance market for making a claim that was the result of a natural disaster where the loss is through no fault of their own and they could have done nothing to prevent the loss or mitigate the damage. Until such time as insurers can show that firestorm victims --- as a group --- pose a greater risk of future loss, the Commissioner has determined that locking these policyholders out of eh insurance market is unfair and poses a serious threat to the health safety and welfare of California citizens

B. Tightening Underwriting Standards

There is more anecdotal evidence that indicates many California insurers are tightening underwriting guidelines in order to lessen their exposure in what are considered by the industry to be “high-risk” or “brush” areas. This anecdotal evidence indicates that insurers may stop writing residential property in fire-prone areas altogether. At town hall meetings in the areas hit by the firestorms survivors report that they are being told by their insurers that companies intend to limit their exposure in these areas. This can be achieved in a number of ways including more restrictive eligibility and underwriting standards.

For instance, by hinging eligibility on claims made in the past, that is, to claims that relate to natural disasters, the insurance industry would make ineligible all victims who made claims relating to the wildfires.

The Commissioner believes these new underwriting standards are and will continue to have a profound effect on the residential property insurance market in California and as such they must be scrutinized. This regulation makes clear the standard by which they will be measured. Further, the Commissioner believes that actions of this type on the part of the insurance industry have the potential to exacerbate an already unprecedented availability crisis in California. This regulation represents a reasonable approach and makes clear the Commissioner’s authority to make sure that homeowners insurance remains available to California consumers.

Again, quoting the Supreme Court, “Article 10 is not only about rates and rate regulation; it also concerns other factors that may impermissibly affect the availability of insurance.” (*State Farm*, *supra*, 04 C.D.O.S. at page 3574.) The Commissioner has determined that a continuing emergency exists that threatens the health, safety and welfare of California citizens. He has also determined that there currently exists in California evidence which indicates the current availability crisis could worsen making it close to impossible for many California citizens to procure residential property insurance. Clearly the Commissioner is not only justified in attempting to promulgate these regulations on an emergency basis, he is, under the circumstances, duty bound to do so.

6. Conclusion

Having been sued by the insurance industry for simply doing his duty, for simply trying to protect consumers, for merely attempting to enforce the insurance laws of this state, the Commissioner risks further litigation and other legal obstacles should he attempt to enforce the insurance laws as he has interpreted them unless he adheres to the APA rulemaking process. This regulation is the only thing standing between the insurance consumers of this state and an insurance industry that has proven by its actions relating to this regulation that it has little or no interest in the rights of consumers. The Commissioner has determined that the regulation is needed to prevent a worsening of the unprecedented residential property insurance availability crisis that could have a profound impact on California’s halting economic recovery

The Commissioner believes and has determined that an emergency within the meaning of Government Code §11346.1 exists and therefore promulgates this regulation on an emergency basis.

D. Authority and Reference Citations.

The purpose of the regulation is to implement, interpret, and make specific the provisions of California Insurance Code sections CIC §§675, 676, 679.71, 790.06, 791.02, 791.12(b), 1857(a), 1861.05(a), 1861.05(b), 1861.03(a).

E. Informative Digest.

The following describes the specific purpose of each provision of this emergency regulation and the rationale for the determination that each regulation is reasonably necessary to carry out the purpose for which it is proposed.

1. Summary of Existing Law

CIC §675 defines residential property risks. The proposed regulations refer to this definition in defining the scope of the proposed regulation.

CIC §676 provides the legal requirements for a valid notice of cancellation and non-renewal of a residential property insurance policy. The proposed regulation applies to cancellation and nonrenewal of residential property insurance in relation to an “adverse underwriting decision” as defined in CIC §791.02. The proposed regulation clarifies acts that may violate CIC §676.

CIC §679.71 provides an insurer may not refuse to issue a policy of residential property insurance under conditions less favorable to the potential insured than to other comparable potential insureds. The proposed regulation makes clear that loss history falls within the definition of “personal information” within the meaning of CIC 791.02 and that basing an adverse underwriting decision solely on information garnered from insurance-support organization databases may result in a violation of CIC §679.71..

Based on the experience of numerous consumer complaints, and upon the experience of CDI personnel, the Commissioner has determined that in general loss history databases are prone to contain, or be based upon, faulty and / or incomplete data. Therefore the use of these databases, without gathering further information, may be unfairly discriminatory within the meaning of CIC §679.71. The proposed regulation outlines the steps that need to be taken in order to avoid noncompliance with CIC §679.71.

CIC §790.06 provides that under certain circumstances the Commissioner may define what constitutes an unfair insurance practice in noncompliance with CIC §790.02. Certainly any act or practice that was determined to be unfairly discriminatory, per any of the laws pertaining to unfair discrimination, would meet the definition of an unfair insurance business practice.

Based on the experience of numerous consumer complaints, and upon the experience of CDI personnel, the Commissioner has determined that in general loss history databases are prone to contain, or be based upon, faulty and / or incomplete data. Adverse underwriting decisions made without gathering further information, may be unfairly discriminatory within the meaning of CIC §§1861.05 and 679.71. The proposed regulation outlines the steps that need to be taken in order to avoid the strictures of these laws. Unfair discrimination would most certainly be an unfair insurance practice within the meaning of CIC §790.06.

CIC §791.02 provides the definition of adverse underwriting decision used in this regulation. This regulation, through the use of concrete examples, makes more specific this section.

CIC §791.12(b) provides that an insurer may not predicate an adverse underwriting decision on information gathered from an insurance-support organization unless it obtains “further personal information” from some source other than the insurance-support organization. This regulation, through the use of concrete examples, makes more specific this section.

CIC §1857(a) provides, in pertinent part: Every insurer . . . shall maintain reasonable records, of the type and kind reasonably adapted to its method of operation, of its experience . . . of the data, statistics, or information collected or used by it in connection with the rates, rating plans, rating systems, underwriting rules . . . so that those records will be available at all reasonable times to enable the commissioner to determine whether that . . . in the case of an insurer, every rate, rating plan, and rating system made or used by it, complies with the provisions of this chapter applicable to it.

The proposed regulation makes the records requirements in CIC §1857(a) more specific by detailing exactly the kind of records that must be kept in relation to compliance with the various insurance laws regarding, “rates, rating plans, rating systems, underwriting rules.”

CIC §1861.05(a) provides: No rate shall remain in effect that is excessive, inadequate, unfairly discriminatory or otherwise in violation of this chapter. This section necessarily relates to underwriting for a number of reasons. Rates are numbers that are applied through underwriting. The assessment of risk in relation to the potential insured or the potential property to be insured is made by the gathering of information about the insured and the property to be insured. This information is applied, at least in part, through underwriting rules and guidelines. Failure to maintain underwriting guidelines that are sufficiently specific may result in an unfairly discriminatory rate (CCR §2360.2) Underwriting rules that may be sufficiently specific may nonetheless be applied in an unfairly discriminatory manner. The rate charged based on unfairly discriminatory underwriting would be an unfairly discriminatory rate.

The proposed regulation, through the use of concrete examples, makes more specific this section of the CIC as it relates to residential property underwriting.

The question as to whether the Commissioner has jurisdiction over underwriting was put the rest in *Wilson v. Fair Employment and Housing, 46 Cal. App. 4th 1213, 1223; 54 Cal. Rptr. 2d 419, 424; (1996*) where the court stated: . . .the Insurance Commissioner clearly possesses the expertise to evaluate and resolve issues regarding actuarial risks and allegedly discriminatory underwriting practices.

We would also take note that the Office of Administrative Law has also held that CIC §1861.05 prohibition against unfair discrimination extends to underwriting. In *2000 OAL Determination No. 15*, the insurer requesting (the “requester”) the OAL determination argued that CIC §§1861.01 and 1861.05 applied only to rates and not to underwriting. The OAL Determination provides:

> OAL disagrees with the requester that existing law, either statutory or regulatory, limits filing requirements to rates. For filing requirements that go beyond the filing of just “rates,” see Insurance Code section 1861.05(b) (“such other information as the commissioner may require”) and Title 10, CCR, sections 2643.3(b) (“require the filing of such other information as he or she deems necessary to review the application and 2648.4(b) (“submission of relevant underwriting rules”).

Indeed, as the Office of Administrative Law pointed out, there are myriad examples in the current law where the Commissioner takes jurisdiction over underwriting as well as rates as is reviewed in detail below.

CIC §1861.05(b) provides: **“**Every insurer which desires to change any rate shall file a complete rate application with the commissioner. A complete rate application shall include all data referred to in Sections 1857.7, 1857.9, . . . and 1864 and such other information as the commissioner may require." The proposed regulation deals specifically with insurance underwriting and specifically requires the keeping of information relating to declination and nonrenewal of insurance policies. Certainly, at the very least, this type of information would fall into the category of "other information." As such, this regulation, through the use of concrete examples, makes more specific this section.

CIC §1861.03(a) provides**:** (a) The business of insurance shall be subject to the laws of California applicable to any other business, including, but not limited to, the Unruh Civil Rights Act (Sections 51 to 53, inclusive, of the Civil Code), and the antitrust and unfair business practices laws (Parts 2 (commencing with Section 16600) and 3 (commencing with Section 17500) of Division 7 of the Business and Professions Code).

It is clearly within the realm of possibility that an underwriting guideline, either as written or as applied, might run afoul of the Unruh Act. In such a case, the underwriting guideline would most likely be unfairly discriminatory with in the meaning of CIC §1861.05(a). The underwriting guideline might also be an unfair insurance practice within the meaning of CIC §790.06. This regulation, through the use of concrete examples, makes more specific this section.

CCR §2348.4 requires the filing of underwriting eligibility guidelines. Cited as authority for this regulation is CIC §1861.05. The proposed regulation is similar in application yet more narrow in scope as it applies to only residential property insurance. This regulation, through the use of concrete examples, compliments this section.

CCR §2360.0 provides: "Eligibility Guidelines" are specific, objective factors, or categories of specific, objective factors, which are selected and/or defined by an insurer, and which have a substantial relationship to an insured's loss. Cited as authority for this regulation is CIC §1861.05. The proposed regulation, through the use of concrete examples, compliments this section.

CCR §2360.2 requires insurers to "maintain eligibility guidelines for every line of insurance offered for sale to the public." The Eligibility Guidelines shall be sufficiently detailed to determine the appropriate plan for the insured." Cited as authority for this regulation is CIC §1861.05. The proposed regulation is similar in application yet more narrow in scope as it applies to only residential property insurance. This regulation, through the use of concrete examples, compliments this section.

CCR §2348.4 sets forth the requirement for a complete rate change application. Subsection (b) clearly refers to "underwriting rules." Cited as authority for this regulation is CIC §1861.05. The proposed regulation is similar in application yet more narrow in scope as it applies to only residential property insurance. This regulation, through the use of concrete examples, compliments this section.

Conclusion

The proposed regulation, through the use of concrete examples, implements, interprets and makes specific several CIC sections.

As to the Commissioner’s authority to promulgate these regulations, it is illogical to take the position that while the Commissioner has jurisdiction over “rates,” which in most cases are simply numbers, he may not have jurisdiction over how those rates are applied. It is illogical to believe the Commissioner has authority to prevent unfair discrimination in rates, but does not have jurisdiction over eligibility guidelines which set forth the perimeters regarding who will be written, which necessarily changes the pool of risk, and therefore directly affects losses which are a major component of rates. It is illogical to believe the Commissioner has no authority to review any and all records of an insurer, to ensure the insurer is in compliance with all provisions of the CIC and CCR, and to bring enforcement actions where necessary.

2. Description of Specific Provisions

The following are statements of specific purpose and effect of each section of the proposed regulation including the rationale for the determination that each subdivision is reasonably necessary to carry out the purpose for which it is proposed. The public problem has been discussed in detail. This proposed regulation is designed to address the homeowners insurance availability crisis in California.

Proposed California Code of Regulations section 2361(a)

The proposed subsection states that proposed California Code of Regulations (CCR) section 2361, subsections (a) through (f) apply to residential property risks subject to California Insurance Code (CIC) section 675. This subsection defines the scope and applicability of proposed CCR §2361.

Proposed California Code of Regulations section 2361(b)

This proposed subsection set forth definitions for the terms used substantively in the section. The subsection sets forth the scope and applicability of the proposed section by providing that the definitions apply when an insurer considers losses or loss exposure in residential property insurance rating and underwriting.

Proposed California Code of Regulations section 2361(b)(1)

This proposed subsection defines the term “substantial relationship to loss exposure” by providing that a substantial relationship to the loss exposure exists when a hazard, physical condition, or liability exposure creates a material and identifiable effect on the likelihood of a covered loss.

The Commissioner believes that the term “substantial relationship to risk of loss exposure” has been the cause of some confusion for the insurance industry. This confusion is in part the source of a lack of availability in the homeowners insurance market. The stated purpose of Proposition 103 "is to protect consumers from arbitrary insurance rates and practices, to encourage a competitive insurance marketplace, to provide for an accountable Insurance Commissioner, and to ensure that insurance is fair, available, and affordable for all Californians." The Commissioner is charged with enforcing Proposition 103 and all other CIC provisions. The Commissioner believes proposing this definition, and the other definitions contained herein, is necessary to ensure homeowners insurance remains available in California.

This proposed subsection is intended to define the term “substantial relationship to risk of loss exposure” in a clear and concise manner to better facilitate insurance industry understanding of the meaning of the term. Where the term is substantively applied the intent is to make specific the meaning of the term and its relationship to other applicable and relevant insurance laws.

Proposed California Code of Regulations section 2361(b)(2)

This proposed subsection defines the term “increased risk of loss” by providing an increased risk of loss exists when a property or liability hazard or physical condition is identified or discovered which both bears a substantial relationship to the loss exposure and presents a greater likelihood of future loss than if the hazard or condition did not exist.

The Commissioner believes that the term “increased risk of loss” has been the cause of some confusion for the insurance industry. This confusion is in part the source of a lack of availability in the homeowners insurance market. The stated purpose of Proposition 103 "is to protect consumers from arbitrary insurance rates and practices, to encourage a competitive insurance marketplace, to provide for an accountable Insurance Commissioner, and to ensure that insurance is fair, available, and affordable for all Californians." The Commissioner is charged with enforcing Proposition 103 and all other CIC provisions. The Commissioner believes proposing this definition, and the other definitions contained herein, is necessary to ensure homeowners insurance remains available in California.

This proposed subsection is designed to define the term “increased risk of loss” in a clear and concise manner to better facilitate insurance industry understanding of the meaning of the term. Where the term is substantively applied the intent is to make specific the meaning of the term and its relationship to other applicable and relevant insurance laws.

Proposed California Code of Regulations section 2361(b)(3)

This proposed subsection set forth definitions for the terms used substantively in the section. The subsection sets forth the scope and applicability of the proposed section by providing that the definitions apply when an insurer considers losses or loss exposure in residential property insurance rating and underwriting.

This subsection specifically defines the term “fully remedied or otherwise resolved.”

The intent is to make clear the meaning of the term as used substantively later in the regulation.

Proposed California Code of Regulations section 2361(b)(3)(i)

This subsection defines a fully remedied or otherwise resolved loss or loss exposure as existing when the property has been returned to a state of repair that is equal or superior to the condition existing prior to the occurrence or condition which created the increased risk of loss.

For example, where there is a claim based on water damage caused by a leaky roof and the roof is replaced, that situation would be considered fully remedied or otherwise resolved.

The Commissioner believes that the term “fully remedied or otherwise resolved” needs to be defined in order to avoid confusion that may impact availability in the homeowners insurance market. The stated purpose of Proposition 103 "is to protect consumers from arbitrary insurance rates and practices, to encourage a competitive insurance marketplace, to provide for an accountable Insurance Commissioner, and to ensure that insurance is fair, available, and affordable for all Californians." The Commissioner is charged with enforcing Proposition 103 and all other CIC provisions. The Commissioner believes proposing this definition, and the other definitions contained herein, is necessary to ensure homeowners insurance remains available in California.

This proposed subsection is designed to define the term in a clear and concise manner to better facilitate insurance industry understanding of the meaning of the term. Where the term is substantively applied the intent is to make specific the meaning of the term and its relationship to other applicable and relevant insurance laws.

Proposed California Code of Regulations section 2361(b)(3)(ii)

This subsection defines a fully remedied or otherwise resolved loss or loss exposure as existing when the liability hazard insured against has been reduced to equal or below the level existing prior to the loss or loss exposure.

For example, where there is a claim based on electric wiring and the entire system has been fully upgraded, in that situation the hazard insured against would have been reduced to equal or below the prior existing level.

The Commissioner believes that the term “fully remedied or otherwise resolved” needs to be defined in order to avoid confusion that may impact availability in the homeowners insurance market. The stated purpose of Proposition 103 "is to protect consumers from arbitrary insurance rates and practices, to encourage a competitive insurance marketplace, to provide for an accountable Insurance Commissioner, and to ensure that insurance is fair, available, and affordable for all Californians." The Commissioner is charged with enforcing Proposition 103 and all other CIC provisions. The Commissioner believes proposing this definition, and the other definitions contained herein, is necessary to ensure homeowners insurance remains available in California.

This proposed subsection is designed to define the term in a clear and concise manner to better facilitate insurance industry understanding of the meaning of the term. Where the term is substantively applied the intent is to make specific the meaning of the term and its relationship to other applicable and relevant insurance laws.

Proposed California Code of Regulations section 2361(b)(3)(iii)

This subsection defines a fully remedied or otherwise resolved loss or loss exposure as existing when the increased risk of loss has been entirely eliminated because the property is no longer owned by the insured, the liability hazard is no longer the responsibility of the insured, the policy no longer provides coverage for that exposure, or the condition that caused the increased risk of loss has been removed.

For example where the loss is based on the insured’s dog, where the insured no longer has a dog, the hazard insured against has been completely eliminated.

The Commissioner believes that the term “fully remedied or otherwise resolved” needs to be defined in order to avoid confusion that may impact availability in the homeowners insurance market. The stated purpose of Proposition 103 "is to protect consumers from arbitrary insurance rates and practices, to encourage a competitive insurance marketplace, to provide for an accountable Insurance Commissioner, and to ensure that insurance is fair, available, and affordable for all Californians." The Commissioner is charged with enforcing Proposition 103 and all other CIC provisions. The Commissioner believes proposing this definition, and the other definitions contained herein, is necessary to ensure homeowners insurance remains available in California.

This proposed subsection is designed to define the term in a clear and concise manner to better facilitate insurance industry understanding of the meaning of the term. Where the term is substantively applied the intent is to make specific the meaning of the term and its relationship to other applicable and relevant insurance laws.

Proposed California Code of Regulations section 2361(b)(4)

This proposed subsection defines the term adverse underwriting by referring to California Insurance Code Section 791.02.

The Commissioner believes this definition and reference is necessary to ensure the entities to which this regulation will apply have a clear and concise understanding of the use and application of the term.

Proposed California Code of Regulations section 2361(c)

This proposed subsection provides that where an adverse underwriting decision is based on losses or loss exposure, when otherwise allowed by law, the adverse underwriting decision shall be based upon conditions of the individual risk which bear a substantial relationship to the loss exposure and which present an increased risk of loss when compared to other risks eligible for coverage under the insurer's underwriting guidelines.

This proposed subsection also provides that an insurer shall not base, in whole or in part, an adverse underwriting decision on losses or loss exposures that have been fully remedied or otherwise resolved. The proposed subsection provides that losses or loss exposures that have been fully remedied or otherwise resolved are no longer substantially related to the risk of loss.

The Commissioner believes that this subsection is required in order to make clear the application of this section, and to also make clear how the various defined terms interact. This section is necessary to promote proper underwriting in the homeowners lines of insurance. This section is also necessary in order to avoid confusion that may impact availability in the homeowners insurance market. The stated purpose of Proposition 103 "is to protect consumers from arbitrary insurance rates and practices, to encourage a competitive insurance marketplace, to provide for an accountable Insurance Commissioner, and to ensure that insurance is fair, available, and affordable for all Californians." The Commissioner is charged with enforcing Proposition 103 and all other CIC provisions. The Commissioner believes proposing this definition, and the other definitions contained herein, is necessary to ensure homeowners insurance remains available in California.

The intent of this proposed subsection is to make clear that there can be no justification for basing an adverse underwriting decision on losses or loss exposures which no longer exist because they bear no relations to the risk of loss.

This proposed subsection is designed to make application of the section clear and concise to better facilitate insurance industry understanding of the meaning of the term.

Proposed California Code of Regulations section 2361(d)

This proposed subsection provides that an insurer shall not base an adverse underwriting decision, in whole or in part, on an inquiry regarding coverage, unless a hazard or condition is identified which both bears a substantial relationship to loss exposure and presents an increased risk of loss.

The intent of this proposed subsection is to make clear that mere inquires cannot be used to form the basis of an adverse underwriting decision because inquiries bear no relationship to the future risk of loss. An inquiry about mold coverage does not cause the house to get toxic mold.

The Commissioner believes that this subsection is required in order to make clear the application of this section, and to also make clear how the various defined terms interact. This section is necessary to promote proper underwriting in the homeowners lines of insurance. This section is also necessary in order to avoid confusion that may impact availability in the homeowners insurance market. The stated purpose of Proposition 103 "is to protect consumers from arbitrary insurance rates and practices, to encourage a competitive insurance marketplace, to provide for an accountable Insurance Commissioner, and to ensure that insurance is fair, available, and affordable for all Californians." The Commissioner is charged with enforcing Proposition 103 and all other CIC provisions. The Commissioner believes proposing this definition, and the other definitions contained herein, is necessary to ensure homeowners insurance remains available in California.

This proposed subsection is designed to make application of the section clear and concise to better facilitate insurance industry understanding of the meaning of the term.

Proposed California Code of Regulations section 2361(e)

This proposed subsection provides that that an insurer shall gather adequate information to determine that an increased risk of loss exists before a loss, loss exposure, or an inquiry with respect to coverage can be used as grounds for an adverse underwriting decision. The proposed section adds that in accordance with California Insurance Code Section 791.12, an insurer cannot rely solely on information obtained from an insurance-support organization. The proposed section also provides that if the information is from an insurance support-organization, the insurer shall obtain further relevant information in addition to the material obtained from the insurance-support organization. Sources for this information may include the insurance application or supplemental application, telephone inquiry, written inquiry, and physical inspection.

It is the intent of this proposed regulation to make clear that an adverse underwriting decision must be based on exposure to loss, therefore an insurer must gather sufficient information to make a reasonable determination about what the actual loss exposure is before using that loss exposure to rate the policy.

The Commissioner believes that this subsection is required in order to make clear the application of this section, and to also make clear how the various defined terms interact. This section is necessary to promote proper underwriting in the homeowners lines of insurance. This section is also necessary in order to avoid confusion that may impact availability in the homeowners insurance market. The stated purpose of Proposition 103 "is to protect consumers from arbitrary insurance rates and practices, to encourage a competitive insurance marketplace, to provide for an accountable Insurance Commissioner, and to ensure that insurance is fair, available, and affordable for all Californians." The Commissioner is charged with enforcing Proposition 103 and all other CIC provisions. The Commissioner believes proposing this definition, and the other definitions contained herein, is necessary to ensure homeowners insurance remains available in California.

This proposed subsection is designed to make application of the section clear and concise to better facilitate insurance industry understanding of the meaning of the term.

Proposed California Code of Regulations section 2361(f)

The proposed section provides that where an insurer makes an adverse underwriting decision, the insurer shall maintain documentation detailing the hazards or physical conditions which created an increased risk of loss and how this information was considered in policy rating or underwriting. The proposed subsection adds that this documentation shall be maintained during the time in which the policy is in force and otherwise as required by law.

The Commissioner believes that this subsection is required in order to make clear the application of this section, and to also make clear how the various defined terms interact. This section is necessary to promote proper underwriting in the homeowners lines of insurance. This section is also necessary to enable CDI to verify compliance with the insurance laws.

This proposed subsection is designed to make application of the section clear and concise to better facilitate insurance industry understanding of the meaning of the term.

3. Federal law

There is no existing, comparable federal regulation or statute.

4. Small Business

The proposed regulation has no effect on small business in the state of California.

F. Specific Agency Statutory Requirements

On June 27, 2003, in compliance with California Insurance Code Section 12921.7, a notice of proposed emergency action was mailed by CDI to every person, group, or association that had previously filed a request with the Commissioner for notice of regulatory action. The same notice was mailed to every property and casualty insurer licensed to do business in California. A copy of the Notice and proof of mailing is also enclosed.

G. Fiscal Impact / Cost Statement / Local Mandate Determination

The Commissioner has determined that the regulatory action imposed herein will result in no program mandates on local agencies.

H. Fiscal Impact / Cost Statement / Local Agencies and School Districts

The Commissioner has determined that the regulatory action imposed herein will result in no program mandates on local agencies or school districts.

I. Cost Statement

The Commissioner has determined that this regulation does not impose any cost or result in any savings to any state agency, local agency, or school district that is required to be reimbursed under Part 7 (commencing with Section 17500) of Division 4 of the Government Code, nor does the regulation cause any other non-discretionary cost or savings imposed on local agencies, nor does the regulation have any effect on federal funding to the state.

J. Pre-adoption consultation with interested persons.

While the Commissioner has done everything in his power to work with the insurance industry and consumer groups to find solutions to the various problems facing the homeowners insurance market in California, no interested person was consulted specifically in relation to this proposed regulation.

H. Fiscal Impact Estimate / Form 399

The Fiscal Impact Estimate / Form 399 is incorporated by reference. **This Notice incorporates by reference any and all documents associated with the Office of Administrative law file numbers 03-0710-03E, 03-1110-02EE and 04-0303-01 EE.**